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IN THE

# Supreme Court of the United States

October Term, 1950.

No. 544

GEORGE T. GOODELL, as Receiver of the Estate of Salsbury Motors, Inc., Debtor,

*Petitioner,*

vs.

BANK OF AMERICA NATIONAL TRUST & SAVINGS ASSOCIATION,

*Respondent.*

**Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.**


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IN THE

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October Term, 1950.

No. .....

GEORGE T. GOGGIN, as Receiver of the Estate of Salsbury Motors, Inc., Debtor,

*Petitioner,*

*vs.*

BANK OF AMERICA NATIONAL TRUST & SAVINGS ASSOCIATION,

*Respondent.*

**Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.**

*To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:*

Your petitioner, George T. Goggin[1], as receiver of the estate of Salsbury Motors, Inc.[2] prays that a writ of certiorari issue to review the final judgment of the United States Court of Appeals for the Ninth Circuit in favor of the Bank of America National Trust & Savings Association,[3] which judgment was entered by that court on January 5, 1951, and on which the receiver's petition for

[1]Hereinafter referred to as "Receiver."

[2]Hereinafter referred to as "Salsbury" or "debtor".

[3]Hereinafter referred to as "Bank" or "Bank or America".

rehearing was denied by that court on February 15, 1951.

Except for the issue as to the effect of a prior appeal between the same parties in the same Chapter XI proceeding,[4] the opinion of the Court of Appeals resolved all of the issues presented by the appeal in favor of the receiver who was the appellant. The court, however, affirmed the judgment of the bankruptcy court (both that of the referee in bankruptcy and the district judge) that the previous banker's lien appeal determined not only the validity of the Bank's claim against the debtor as a legal obligation but, also, that no grounds existed for the subordination of the Bank's claim to the claims of other creditors. Although it was conceded by the Bank that neither the pleadings nor the evidence in the banker's lien proceeding raised any issue as to the subordination of the Bank's claim to the claims of other creditors,[5] the Court of Appeals for the

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[4]Hereinafter referred to as "bankers lien appeal."

This case is reported at 183 F. 2d 322. A petition for certiorari was denied by this court on November 6, 1950, 340 U. S. 877, 71 Sup. Ct. 122, and a petition for rehearing denied on December 4, 1950, 340 U. S. 898, 71 Sup. Ct. 237. By reason of the binding effect given the banker's lien order by the Court of Appeals for the Ninth Circuit in the instant case, we shall have occasion herein to refer to the record in the banker's lien proceeding which was before this Court on the aforementioned petition for certiorari as No. 311 of the October Term for 1950. References in this petition to the transcript of record in the banker's lien petition for certiorari will be designated as: "B. L. Tr."

[5]Page 7 of the Bank's brief before the Court of Appeals for the Ninth Circuit contains the following statement:

> "While it is true that the grounds for subordination here urged by counsel for the receiver were not raised by him at the time he objected to the Bank's claim, they should have been urged at that time (and undoubtedly would have been) if they had any substantial merit."

Ninth Circuit construed the last paragraph of the banker's lien order as having decided that question and, therefore, ruled that the bankruptcy court was without jurisdiction to entertain the receiver's petition to subordinate the claim of the Bank to the claims of other creditors; that petition contained allegations to the effect that the Bank had knowingly induced other creditors to extend credit to the debtor by wilfully giving them false information concerning the debtor's financial condition.

## Opinions Below.

The opinion of the Court of Appeals for the Ninth Circuit is set forth in its entirety at pages 195 to 202 of the record herein and is reported at 186 F. 2d 158. Neither the District Court nor the referee in bankruptcy wrote opinions but their respective orders are included as a part of this record at pages 150 and 83.

## Jurisdiction.

The judgment of the United States Court of Appeals for the Ninth Circuit was filed on January 5, 1951 [Tr. 202], and the receiver's petition for rehearing was denied by that court on February 15, 1951 [Tr. 203]. The jurisdiction of this Court is invoked under Title 28, U. S. C., Section 1254, as amended by the Act of June 25, 1948 (Public Law 773, 80th Congress; Chapter 646, 2nd Session); and as further amended, and under Section 24(c) of the Bankruptcy Act, 11 U. S. C., Section 47(c).

## Questions Presented.

1. In a Chapter XI proceeding, is an order of the bankruptcy court allowing a claim over objections of the receiver *res judicata* in a subsequent action in the same Chapter XI proceeding whereby the receiver seeks to subordinate the payment of any dividends on such allowed claim upon equitable grounds not theretofore raised or litigated?

2. Does the pendency of an appeal from an order of the bankruptcy court allowing a claim over objections of the receiver divest the bankruptcy court of jurisdiction to hear and determine the receiver's petition to subordinate the payment of any dividends on that claim upon equitable grounds not theretofore raised or litigated?

## Statutes Involved.

This petition requires a consideration of the following provisions of the Bankruptcy Act:

(1) Section 2(a)(2) invests courts of bankruptcy with jurisdiction to "allow claims, disallow claims, reconsider allowed or disallowed claims, and allow or disallow them against bankrupt estates . . ."

(2) Section 57(k) provides: "Claims which have been allowed may be reconsidered for cause and reallowed or rejected in whole or in part according to the equities of the case, before but not after the estate has been closed."

**Statement.**

Prior to the confirmation of a plan of arrangement proposed by the debtor, the Bank of America filed a claim in the Chapter XI proceedings against the debtor in an amount in excess of $600,000.00, of which the Bank alleged that approximately $380,000.00 was secured, leaving a claimed balance unsecured in the sum of approximately $126,000.00 [Tr. 124-147]. The claim showed on its face that the Bank had applied against the amount of its claim the balance on deposit in the debtor's account with the Bank under its right of offset and had also exercised a banker's lien upon notes and drafts which had been held by the Bank as a collection agent for the debtor. After the said claim had been filed, and prior to confirmation of the plan of arrangement, the receiver filed objections to the claim with a prayer for affirmative relief on the ground that the Bank had wrongfully seized the commercial paper belonging to the debtor under an alleged, but invalid, claim of banker's lien. The referee overruled the receiver's objections to the Bank's claim and denied his prayer for affirmative relief. The referee's ruling was affirmed by the District Court on review and that order was affirmed by the Court of Appeals for the Ninth Circuit; this Court denied certiorari.[6]

The instant proceedings are separate and distinct from the aforesaid objections to the claim. These proceedings were commenced with the receiver's petition and supple-

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[6]See Note 4, *supra*.

ment thereto [Tr. 58-65], the allegations of which can be summarized as follows:

> The Bank of America was thoroughly familiar with the many financial reports regularly submitted to it by the debtor. These reports showed that for a considerable period of time prior to the commencement of the Chapter XI proceedings, the debtor was insolvent and was in default under its loan agreement with the Bank. During this period, the Bank was aware of the fact that the debtor was giving the Bank as a credit reference to all persons making credit inquiries of the debtor and that in response to such inquiries, the Bank, despite the aforesaid knowledge of the unsound financial condition of the debtor, gave information to all who inquired that the debtor was in sound financial condition and that it was a wholly-owned subsidiary of Northrop Aircraft and indicated that Northrop would pay the debts of Salsbury, the debtor herein (which the Bank knew was not true). The Bank gave similar information to credit agencies, which information the Bank knew would be included in financial reports distributed by those agencies and which reports would be used by persons in determining whether or not to extend credit to the debtor. The persons who are now the existing unsecured trade creditors of the debtor, relied upon this misinformation furnished by the Bank in determining to extend credit to the debtor. At all times referred to in the pleadings, the Bank knew that the debtor was insolvent and was in default under its loan agreement with the Bank.

The foregoing summary of the pleadings relates only to the original pleadings. The amended petition of the

receiver was not ruled upon by the referee and, apparently, was not ruled upon by the District Court because the referee indicated that he would not consider the amended petition in connection with his ruling, having expressly refused to give the receiver leave to file it [Tr. 165-166]. The amended petition contained a more complete statement of facts upon which the receiver relied in support of his prayer to subordinate the claim of the Bank [Tr. 92-107].[7]

A separate aspect of the subordination petition and supplement thereto pertains to the sum of $75,000.00 paid to the receiver by Northrop Aircraft, Inc., a corporation, which was the parent owning all of the capital stock of the debtor in this proceeding. Northrop Aircraft, Inc., had filed a claim against the debtor for a sum in excess of $1,000,000.00, and the receiver had filed objections thereto with a prayer for affirmative relief on the ground that Northrop was the *alter ego* of the debtor and was, therefore, liable for all of the debtor's indebtedness. The controversy between Northrop Aircraft, Inc., and the receiver was compromised and settled in consideration of

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[7]In view of the fact that the referee's order included a ruling that the said petition and supplement did not state facts sufficient to warrant the granting of any relief, the receiver sought leave to file an amended petition which the referee initially refused to grant [Tr. 155-157, 159-160]. Eventually, the referee permitted the receiver to file the amended petition but he made it clear that he would not "pay any attention to it" [Tr. 165]. The amended petition was filed and is included in this record [Tr. 92-107]. The amended petition includes a more complete and detailed statement of grounds urged by the receiver as requiring subordination of the Bank's claim, which additional details were acquired by the receiver through use of the discovery procedure provided by the Federal Rules of Civil Procedure. Thus, the receiver's amended petition contained a positive allegation that the Bank had given to Dun & Bradstreet false information pertaining to the debtor's financial condition. [Tr. 99].

Northrop's paying to the estate the sum of $75,000.00 and agreeing to subordinate its entire claim against the debtor to the claims of all of the other creditors. The payment of said $75,000.00 to the receiver was expressly agreed to be based upon the *alter ego* contentions of the receiver against Northrop Aircraft, Inc. [Tr. 49-52]. In the receiver's petition in the instant case, he alleged that the $75,000.00 payment in compromise of his *alter ego* contentions against Northrop Aircraft, Inc., could not equitably be the basis for the payment of any dividends to the Bank because the Bank, in extending credit to the debtor herein, was the only one of all the unpaid creditors that had been specifically informed by Northrop that Northrop would not be responsible for the obligations of the debtor, and that by reason of this fact the Bank had insisted that Northrop agree to subordinate the payment of all of its claims against the debtor until the claim of the Bank was paid. On the basis of these allegations, the receiver, in addition to praying for subordination of the entire claim of the Bank of America, as hereinabove described, concluded with a prayer that if the Court did not grant the complete subordination prayed for, the Bank of America should not, for the reasons stated, participate in any dividends from the $75,000.00 paid into the estate by Northrop Aircraft, Inc., in settlement of the *alter ego* contentions of the receiver.

On the day set for the hearing of the receiver's petition and supplement thereto to subordinate the payment of any dividends on the claim of the Bank of America, the Bank served and filed a document entitled "RESPONSE TO ORDER TO SHOW CAUSE RE PETITION OF RECEIVER FOR ORDER SUBORDINATING THE CLAIMS OF BANK OF AMERICA NATIONAL TRUST & SAVINGS ASSOCIATION" [Tr. 79].

In that response the Bank set forth the following objections to the receiver's petition:

1. The bankruptcy court was without jurisdiction to entertain the receiver's petition by reason of the pending banker's lien appeal.

2. The bankruptcy court was without jurisdiction to determine such a controversy as that presented by the receiver's petition to subordinate the Bank's claim because no such jurisdiction had been reserved in the order confirming the plan of arrangement.

3. The receiver did not have the power or authority to seek the relief requested in his petition to subordinate the claim of the Bank of America.

4. Even if the facts set forth in the receiver's petition to subordinate the claim of the Bank of America were true, there was no lawful ground for the relief therein requested.

The order of the referee provided that all of the objections were well founded and, therefore, denied the receiver's petition to subordinate the Bank's claim and dismissed the order to show cause issued thereon [Tr. 83-85]. A similar form of order was entered by the District Judge on review from the referee's order [Tr. 150-152].

On appeal to the U. S. Court of Appeals for the Ninth Circuit, however, that court ruled that but for the banker's lien appeal, the bankruptcy court had jurisdiction to grant the relief requested and that the receiver's petition did state a claim upon which relief could be granted. Despite its disagreement with the bankruptcy court's holding on the second, third and fourth grounds of objections urged by

the Bank of America, the Court of Appeals nevertheless affirmed the ruling below because:

> "We are persuaded that the last paragraph of said [banker's lien] order decided the question of priority of the Bank's claim and the appeal took with it jurisdiction of the referee to act on that question." [Tr. 201.][8]

Inasmuch as the ruling of the Court of Appeals was favorable to the petitioner in all respects except as to the effect of the prior appeal, this petition for certiorari is limited to that point.

The receiver petitioned the Court of Appeals for the Ninth Circuit for a rehearing upon the following grounds:

1. The banker's lien order did not involve any issue or the consideration of any evidence as to subordination of the bank's claim and, therefore, could not have determined any such issue.

2. Even if the banker's lien order is construed as determining the order of payment of dividends on the Bank's claim, the petition for subordination should be considered as a petition for reconsideration of the order of allowance under Section 57(k) of the Bankruptcy Act.

3. The banker's lien appeal was from an interlocutory order in a proceeding in bankruptcy and, therefore, its pendency did not divest the bankruptcy court of jurisdic-

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[8]The paragraph in question reads as follows:

"It Is Further Ordered that said Claimant shall be entitled to dividends upon the said claim at the same rate paid to unsecured creditors when the remainder of the security held by said Claimant has been liquidated and the proceeds applied upon the unpaid balance of said claim." [Tr. 179; B. L. Tr. 92.]

tion to act on the question of subordination of the Bank's claim.

4. If the banker's lien appeal was deemed to have divested the bankruptcy court of jurisdiction to act on a petition for subordination, the Court of Appeals was requested in its mandate to direct the bankruptcy court to hear and determine the receiver's amended petition.

The petition for rehearing was denied by the Court of Appeals on February 15, 1951, without opinion [Tr. 203].

**Reasons for Granting the Writ:**

1. The decision of the Court of Appeals is in conflict with applicable decisions of this Court.

2. The decision of the Court of Appeals is in direct conflict with decisions of the Courts of Appeals for the First and Second Circuits.

3. The decision of the Court of Appeals is in conflict with Section 57(k) of the Bankruptcy Act and is of such far-reaching importance in bankruptcy administration as to call for the exercise of this Court's power of supervision.

Because of the binding effect given by the Court of Appeals to the banker's lien order, it is necessary to preface the discussion of the reasons for granting the writ by a reference to the banker's lien proceeding. We respectfully request this court to consider the record in the banker's lien case to determine whether or not that proceeding either decided or in any way involved the subordination issues presented by the instant proceedings. The banker's lien proceeding was commenced by the receiver's "OBJECTIONS TO THE CLAIM OF THE BANK OF AMERICA AND PRAYER FOR AFFIRMATIVE RELIEF" [B. L. Tr. 48]. An examination of that document reveals that

it was in no sense intended to defeat the claim of the Bank. The Bank's claim had indicated that it was secured by a deed of trust on real estate belonging to the debtor and in his objections the receiver sought to defer a determination of the amount of the Bank's claim until the security held by the Bank had been liquidated. The second aspect of that proceeding was in the nature of a counterclaim asserted by the receiver in which he sought to have the Bank turn over to the estate the commercial paper upon which the Bank had asserted a banker's lien. At no time has the receiver, either in the banker's lien proceeding or the instant proceeding, ever contended that the Bank did not have a valid claim against the debtor. An examination of the record in the banker's lien case shows without any question that the only issue involved was whether or not the Bank had wrongfully seized and converted certain property which the receiver contended belonged to the debtor.[9] The receiver requested that the Bank be required to pay over to the receiver the value of the seized property. It has now been finally determined that the receiver cannot have that relief. If, however, the receiver had been successful in that litigation, the allowable amount of the Bank's claim against the debtor would have been increased.

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[9]On page 2 of the Bank's Brief in opposition to the petition for writ of certiorari (Docket No. 311 of the October Term for 1950), there is a statement of the Bank's version of the question presented, the statutes involved and the statement of facts. There is not the remotest similarity between that discussion and the issues presented to the court on the receiver's petition for subordination. The question was stated by the Bank as follows:

> May a bank assert a banker's lien pursuant to California Civil Code, Section 3054, upon notes and drafts belonging to the debtor in its hands at the time of filing of a petition under Chapter XI of the Bankruptcy Act, when such notes and drafts had been deposited for collection and credit to the deposit account of the debtor in the usual course of business, and when

The present proceeding, however, is based upon the premise that the Bank will ultimately have a liquidated claim against the debtor, and the receiver seeks in this proceeding to have the payment of dividends on such claim subordinated to the payment of dividends on claims of other creditors. The fundamental difference between the allowance of the claim as a legal debt of the debtor estate, and the order of payment of dividends on that claim has been made clear by a consistent line of decisions of this Court of which one of the leading cases is *Pepper v. Litton* (1939), 308 U. S. 295 at 310, 84 L. Ed. 281, 60 S. Ct. 238, 41 Am. B. R. (N. S.) 279, in which this Court stated:

> "Though disallowance of such claims will be ordered where they are fictitious or a sham, these cases do not turn on the existence or non-existence of the debt. Rather they involve simply the question of order of payment."

Notwithstanding the fact that there was no pleading, issue or evidence involved in the banker's lien proceeding in any way related to the subordination question, the Court of Appeals has seized upon the last sentence of the

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there existed a past due indebtedness from the debtor to the bank.

The Bank indicated that the statutes involved on that appeal were Section 3054 of the Civil Code of California, which is a codification of the common law banker's lien, and Section 67b of the Bankruptcy Act giving recognition to statutory liens created or recognized by the laws of any states. Moreover, the Bank expressly accepted the statement of facts contained in the receiver's petition for certiorari in the banker's lien case, a reading of which conclusively demonstrates that the only issue involved in that proceeding was the propriety of the Bank's exercise of the banker's lien [pages 4-11 of the petition for writ of certiorari to the United States Court of Appeals for the Ninth Circuit docketed in this court as No. 311 of the October Term of 1950].

referee's order in the banker's lien case as somehow having disposed of the parity question.

That order was in the same document as were the findings of fact and conclusions of law. It commences with the formal provisions denying the receiver's petition and dismissing the order to show cause issued thereon and then provides that the Bank's claim against the debtor should be allowed in a certain sum less the following amounts:

1. The proceeds from the commercial paper upon which the Bank had exercised its banker's lien.

2. The proceeds from the sale of the real property on which the Bank held a deed of trust.

The order then concluded as follows:

> "It is further ordered that said claimant shall be entitled to dividends upon the said claim at the same rate paid to unsecured creditors when the remainder of the security held by said claimant has been liquidated and the proceeds applied upon the unpaid balance of said claim."

To be sure, the quoted paragraph of the order contained words to the effect that the claimant is entitled to dividends on its claim at the same rate paid to unsecured creditors, but read in context it clearly appears that the language was used merely to instruct the receiver that no dividends were to be paid to the Bank until the security held by the Bank had been liquidated and the proceeds applied upon the claim.

These facts raise the relatively simple, but extremely important issue that we are petitioning this Court to decide, not only for the benefit of the many unsecured and unpaid creditors of the debtor in the instant case but, also, for the guidance of courts of bankruptcy throughout the United States.

## I.

## The Decision of the Court of Appeals Is in Conflict With Applicable Decisions of This Court.

Although it was conceded by the Bank that neither the pleadings nor the evidence in the banker's lien proceeding raised any issue as to the subordiantion of the bank's claim to the claims of other creditors, the Court of Appeals construed the last paragraph of the banker's lien order as having decided the subordination question, and, therefore, ruled that the bankruptcy court lost jurisdiction to act on the receiver's subordination petition. This, we respectfully urge, constituted an untenable and erroneous interpretation of the banker's lien order and an unwarranted restriction upon the equitable jurisdiction of the bankruptcy court ". . . to sift the circumstances surrounding any claim to see that injustice or unfairness is not done in administration of the bankruptcy estate.[10]

This Court made it clear in *Pepper v. Litton* (1939), 308 U. S. 295, 84 L. Ed. 281, 60 S. Ct. 238, 41 Am. B. R. (N. S.) 279, that the jurisdiction of a court of bankruptcy to subordinate a claim of one creditor to the claims of other creditors is complete and that it is in no way impaired by the fact that there has been previous litigation concerning the validity of the claim with a final binding judgment that it is a valid claim. In that case the claim filed in the bankruptcy was based upon a final judgment of a Virginia state court which had been twice attacked in

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[10]*Pepper v. Litton* (1939), 308 U. S. 295 at 308, 84 L. Ed. 281, 60 S. Ct. 238, 41 Am. B. R. (N. S.) 279.

the Virginia courts without success. One of the attacks in the state court was made by the trustee in bankruptcy and a ruling against him was affirmed by the Supreme Court of Virginia.

The Court of Appeals for the Fourth Circuit ruled that the validity of the claim was *res judicata* in the bankruptcy proceeding and, therefore, reversed the judgment of the District Court which had held that the bankruptcy court had jurisdiction to consider evidence that the judgment had been obtained through fraud and was, therefore, not entitled to dividends in the bankruptcy proceeding on a parity with the persons who had suffered from the fraud.

In reversing the judgment of the Court of Appeals for the Fourth Circuit, this Court stated:

> "On the pleadings in the state court the validity of the underlying claim was not in issue. Nor was there presented to the state court the question of whether or not the Litton judgment might be subordinated to the claims of other creditors upon equitable principles. The motion on which that proceeding was based challenged the Litton judgment on one ground only, viz., that it was void *ab initio* because it was not confessed by Dixie Splint Coal Company in the manner required by the Virginia statute and because P. H. Smith did not have either an implied or express power to confess it. In other words, in the state court, under the pleadings and practice, the only decree which was asked or could be given in the plaintiff's favor was for cancellation of the judgment

> as a record obligation of the bankrupt. It is therefore plain that the issue which the bankruptcy court later considered was not an issue in the trial of the cause in the state court and could not be adjudicated there." (308 U. S. at 302-303.)

There is no way the quoted language can be reconciled with the ruling of the Court of Appeals for the Ninth Circuit in the instant case.

Of course, there must necessarily be a point where litigation comes to an end. That point was reached in *Heiser v. Woodruff* (1946), 327 U. S. 726, 90 L. Ed. 970, 66 S. Ct. 853. In that case this Court pointed out that unlike the case of *Pepper v. Litton,* the issue of fraud on which the trustee relied in support of his petition to subordinate the claim had actually been raised, tried and disposed of adversely in the non-bankruptcy court which had rendered the judgment upon which the claim in bankruptcy was based. This then became ***res judicata*** and beyond the power of the bankruptcy court to redetermine.

This Court has clearly and unequivocally held that in construing the scope and effect of any judgment where ***res judicata*** or estoppel is involved, the court must resort to the pleadings and evidence presented in the earlier proceeding to determine whether or not the issues raised by the more recent litigation were in fact determined in the earlier litigation, notwithstanding the fact that the

earlier judgment might contain language seemingly disposing of the issues raised in the more recent litigation.

*Vicksburg v. Henson* (1913), 231 U. S. 259;

*Radford v. Myers* (1914), 231 U. S. 725;

*Reynolds v. Stockton* (1891), 140 U. S. 254.

Another decision of this Court which is in conflict with the ruling below is *American Surety Company of New York v. Sampsell* (1946), 327 U. S. 269, 90 L. Ed. 663, 56 S. Ct. 571. In that case this Court upheld the jurisdiction of the bankruptcy court to subordinate the claims of some creditors to claims of other creditors, notwithstanding the fact that the referee had previously allowed all of the claims as general claims in bankruptcy.[11]

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[11]The record that was before this Court in the case of *American Surety Company v. Sampsell* reveals that the trustee in bankruptcy, before filing his petition for subordination of the surety company's claim, had filed objections to the claim, which objections had been overruled. That case was docketed in this Court as No. 142 of the October Term for 1945. At page 49 of the transcript of the record before this Court in that case it appears from the trustee's petition to subordinate the surety company's claim that "after a hearing upon an objection to the claim itself, said claim was allowed as a general claim in the sum of $6987.48 . . . that subsequent to the hearings on the objections to the claim" the trustee discovered the facts warranting subordination.

Thus, the situation there was almost identical to that of the instant case.

## II.

## The Decision of the Court of Appeals Is in Direct Conflict With Decisions of the Courts of Appeals for the First and Second Circuits.

In *Bloch v. Mill Factors Corp.* (2nd Cir., 1941), 119 F. 2d 536, 45 A. B. R. (N. S.) 748, 134 A. L. R. 1188, the Court of Appeals for the Second Circuit clearly held that the allowance of a claim in bankruptcy for a balance due after deducting a credit does not deprive the bankruptcy court of jurisdiction to thereafter hear and determine the trustee's petition alleging that the transaction out of which the credit arose was preferential, where the receipt of the preference was not set up as an objection to the allowance of the claim. This was so notwithstanding the fact that the face of the claim itself showed that the claimant had credited against his claim the proceeds from the sale of certain merchandise upon which the claimant had exercised an alleged factor's lien. In holding that the order allowing the claim was not *res judicata* of the question of preference, although the trustee had filed objections to the claim which he had later withdrawn, the court, through Learned Hand, J., stated:

> "But if the trustee does not plead the defense, the allowance of the claim is not *res judicata* upon the issue of preference, and could not be without confusion of the doctrine of merger with that of estoppel. The allowance, like a judgment, is indeed an effective bar to any subsequent objection to the claim; but it establishes no fact by way of estoppel which

> was not decided, and necessarily decided. When the trustee does not plead the defense the issue cannot be decided; and he may therefore later assert any claim depending upon it." (119 F. 2d at 538.)[12]

And so, in the instant case, the fact that there was no issue raised nor determination made of the question of subordination precludes application of the principle of *res judicata.*

A reading of the banker's lien order shows that the exact amount of the Bank's unsecured claim could not be determined until all of the security was liquidated; in fact, there was even a possibility that the proceeds from the sale of the securities would have been sufficient to pay its claim in full. Such an order is interlocutory.[13]

The banker's lien interlocutory order must have arisen in a proceeding in bankruptcy as distinguished from a controversy arising in proceedings in bankruptcy, as those terms are used in Section 24 of the Bankruptcy Act, otherwise it would not have been appealable. *Petersen v. Sampsell* (9th Cir., 1948), 170 F. 2d 555; *In re Christ's Church of the Golden Rule* (9th Cir., 1949), 172 F. 2d 523. That the banker's lien appeal is a proceeding and not a controversy necessarily follows from cases such as *McDaniel National Bank v. Bridwell* (8th Cir., 1932), 74 F. 2d 311, 26 A. B. R. (N. S.) 748, in which the Court of Appeals for the Eighth Circuit held that an order determining a

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[12]See also Annotation "Ruling on Creditor's Claim in Bankruptcy as *res judicata* in subsequent proceeding by trustee to recover voidable preference or transfer." (1941) 134 A. L. R. 1191.

[13]*Robinson v. Edler* (9th Cir., 1935), 78 F. 2d 817, 29 A. B. R. (N. S.) 502, which involved an order on a claim very similar to that here involved.

bank-claimant's right to set off against its claim the balance in the bankrupt's account with the bank was a proceeding and not a controversy.

It is settled that the taking of an appeal from an interlocutory order in a proceeding in bankruptcy does not divest the bankruptcy court of jurisdiction to take further action in the matter. Thus, in *Matter of Woodruff* (9th Cir., 1941), 121 F. 2d 152, 46 A. B. R. (N. S.) 567, it was held that the bankruptcy court had jurisdiction to hear and determine the account and petition for compensation of the receiver and his attorneys, notwithstanding the fact that there was then pending an appeal from an earlier order of the bankruptcy court in the same proceeding, directing the receiver and his attorneys to petition for compensation and fees.[14]

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[14]In the *Woodruff* case the court stated:

> "Appellant contends that the California court had no jurisdiction to make the order of June 27, 1940, because, at that time, our mandate in *Jackson v. Lynch, supra,* decided May 10, 1940, had not been issued. There is no merit in this contention. The orders reviewed in *Jackson v. Lynch, supra,* were not final judgments or decrees, but were interlocutory orders only. Consequently, the appeal therefrom did not remove the entire case to this court or preclude further proceedings in the court below. *Foote v. Parsons Non-Skid Co.* (C. C. A., 6th Cir.), 196 Fed. 951, 953. See also, *In re F. P. Newport Corp.* (C. C. A., 9th Cir.), 37 A. B. R. (N. S.) 470, 475, 98 F. 2d 453, 456. Much less were such proceedings precluded by a mere stay of mandate." (121 F. 2d at 154.)

See also *Fernow v. Liberty Royalties Corp.* (1944, 10th Cir.), 146 F. 2d 396, 57 A. B. R. (N. S.) 659.

One of the cases cited by the Court of Appeals in support of its ruling in the instant case is *Diamond Laundry Corp. v. California Employment Stabilization Commission* (9th Cir., 1947), 162 F. 2d 398. That case, however, involved appeals from final orders over-

Bankruptcy proceedings are *sui generis* and cannot be compared to the ordinary type of civil litigation.[15] As has already been indicated herein, Section 57(k) of the Act provides a clear recognition of the fact that judgments and orders in bankruptcy do not have the same finality as they have in the ordinary type of litigation. It is settled that the ordinary time limitations imposed by Federal Rules 59 and 60 pertaining to new trials and relief from judgments and orders do not apply to bankruptcy.[16]

In a petition for rehearing filed with the Court of Appeals for the Ninth Circuit, the receiver requested that court to direct, by its mandate, that the bankruptcy court hear and determine the receiver's petition to subordinate the Bank's claim as in effect a petition for reconsideration of the order of allowance. This request was based upon Section 57(k) of the Bankruptcy Act investing the bank-

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ruling a trustee's objections to claims. While that appeal was pending the trustee filed supplemental objections with the bankruptcy court which were substantially the same as the objections involved on the pending appeal. The court held that the bankruptcy court, by reason of the pending appeal, did not have jurisdiction to relitigate the same issues as were then before the Court of Appeals. Such a case is not in point in our case, not only because in our case the banker's lien order was interlocutory, but, also, because the issues in the banker's lien proceedings were not only not identical but wholly without similarity to the issues presented in the subordination proceedings.

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[15]It is for this reason that non-bankruptcy cases such as *Rothschild & Co. v. Marshall* (9th Cir., 1931), 51 F. 2d 897, which was cited by the Court of Appeals for the Ninth Circuit in its opinion in the instant case, cannot be controlling in bankruptcy cases.

[16]See in this connection *Bailey v. Proctor* (1st Cir., 1948), 166 F. 2d 392, and *Indemnity Insurance Co. v. Reisley* (2nd. Cir. 1946), 153 F. 2d 296, and the cases there cited as holding that orders in bankruptcy may be reconsidered at any time while the bankruptcy proceedings remain open.

ruptcy court with jurisdiction to reconsider allowed claims. The request was denied. In *Bailey v. Proctor* (1st Cir., 1948), 166 F. 2d 392, the question was whether or not a reorganization court in bankruptcy had authority to hear and consider a petition to supplement or modify an earlier judgment rendered by the court refusing to confirm a proposed plan of reorganization and ordering an immediate liquidation of the assets of the debtor. The earlier judgment had been appealed to the Court of Appeals for the First Circuit which had affirmed the ruling and this Court denied certiorari. After the mandate of the Court of Appeals came down a petition was filed in the bankruptcy court to supplement or modify the earlier order and it was denied. Thereupon, the proponents of the modification appealed to the Court of Appeals. On that appeal one of the contentions made in support of the ruling of the trial court was that the earlier ruling having been the subject of an appeal and having been affirmed, the reorganization court did not have the power to reconsider any question pertaining to the plan. The court found it unnecessary to decide that question despite indications in its opinion that there was such power, at least upon the filing of the Circuit Court's mandate with the trial court. However, the court went on to point out:

> "We are inclined to think that the proper course of action would have been for the appellants to petition us for leave to file the new plan with the District Court for its consideration, if they thought the circumstances had so changed as to require a modification of that order." (166 F. 2d at 396.)

Although this procedure had not been followed, the court, nevertheless, regarded the argument on appeal as in effect a petition to that court for leave to file a new plan with the district court and went on not only to grant that leave, but to proceed to hear and determine the proposed new plan on its merits, stating:

> ". . . we shall consider that point, treating the appellants' prayer in this case as equivalent to a petition for leave to have the district judge consider the question and granting the petition *nunc pro tunc.* Thus, we shall finally dispose of the case here as if the district judge has power in the first instance." (166 F. 2d at 396.)[17]

The court thereupon approved the new proposed plan and directed the reorganization court to confirm it.

In the instant case the refusal of the Court of Appeals for the Ninth Circuit to treat the petition for subordination as a petition for reconsideration is in direct conflict with the ruling of the Court of Appeals for the First Circuit in *Bailey v. Proctor.*

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[17]The disposition of this question by the Court of Appeals for the First Circuit would seem to be similar to the procedure suggested by the Court of Appeals for the Ninth Circuit in the case of *Rogers v. Consolidated Rock Products Co.* (9th Cir., 1940) 114 F. 2d 108, 44 A. B. R. (N. S.) 59. Although the *Rogers* case was one of those relied upon by the Court of Appeals in the instant case, the receiver attempted by his petition for rehearing filed with that court, to have that court treat the appeal as a petition for reconsideration. This request was denied without opinion.

## III.

**The Decision of the Court of Appeals Is in Conflict With Section 57(k) of the Bankruptcy Act and Is of Such Far-Reaching Importance in Bankruptcy Administration as to Call for the Exercise of This Court's Power of Supervision.**

It is not without significance that it was Section 57(k) of the Bankruptcy Act which was relied upon by this Court in *Pepper v. Litton* as empowering courts of bankruptcy to subordinate the claims of one creditor to claims of others, notwithstanding the fact that the claim is recognized and allowed as a binding, legal obligation. Moreover, this Court made it clear that the right to subordinate thus authorized is in no way impaired by the fact that there has been previous litigation concerning the validity of the claim, with a final binding judgment that it is a valid claim. Whether or not the grounds of subordination are *res judicata* by reason of an earlier order allowing the claim is dependent upon whether or not the issues upon which subordination is based have been previously litigated. *Heiser v. Woodruff* (1946), 327 U. S. 726, 90 L. Ed. 970, 66 S. Ct. 853. The record in the banker's lien proceeding demonstrates that it could not have constituted a determination of any issues presented to the court for decision in the subordination proceedings.

The authorities have recognized that Section 57(k) and 57(l) of the Bankruptcy Act are restrictions upon the

strict doctrine of *res judicata* made necessary by the peculiar nature of bankruptcy proceedings.[18]

In almost every bankruptcy the receiver or a trustee takes over an estate to which he is a total stranger facing all types of legal problems, some of which may not arise until facts are brought to the attention of the receiver or trustee which he would have no way of knowing until they come out in the ordinary course of the bankruptcy administration. To protect the creditors in this situation, Congress has provided that the bankruptcy court has jurisdiction to reconsider allowed claims so long as the estate is open.

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[18]"Bankruptcy proceedings, where time is of the essence, are fraught with dangers of errors and inaccuracies, due to the multiplicity of interested but frequently ill-informed parties, as well as to the comparatively late stage at which a common trustee replaces the individual claimants. The general power of the bankruptcy court within certain limitations to correct its own mistakes or reconsider matters already disposed of, or, as it is called, the right to rehear its orders, *sua sponte* or upon motion of a party in interest, cannot now be seriously controverted. With respect to the bankruptcy court's power to reconsider orders of *allowance* and *disallowance* of claims, the Act is more specific."

3 Collier on Bankruptcy, 14th Ed., 302.

Professor Collier then goes on to refer to Section 57(k) of the Bankruptcy Act as giving bankruptcy courts the authority to reconsider allowed claims at any time prior to the closing of the estate. He also directs attention to the numerous cases holding that the time limitations of Rules 59 and 60 of the Federal Rules pertaining to new trials and relief from judgments and orders do not apply to bankruptcy proceedings. Two such recent cases are *Indemnity Insurance Co. v. Reisley* (2nd Cir., 1946), 153 F. 2d 296, and *Bailey v. Proctor* (1st Cir., 1948), 166 F. 2d 392.

The Court of Appeals for the Second Circuit applies similar reasoning in the *Matter of Jayrose Millinery Co., Inc.* (1937), 93 F. 2d 471, 35 A. B. R. (N. S.) 347.

This jurisdiction exists notwithstanding the fact that dividends might have already been paid on allowed claims.[19]

The instant case demonstrates the wisdom of the Congressional policy behind Section 57(k). A receiver takes over the assets of a debtor which are estimated to be in excess of $2,000,000.00 for the benefit of creditors in excess of $2,700,000.00. It would not be humanly possible within any fixed period of time for a bankruptcy administrator to acquire sufficient information with respect to such a vast and complicated business to enable him to assert all of the facts, objections, or defenses that might exist with respect to any claim or to assert reasons that it should be subordinated. By reason of the nature of the proceedings he might not come into posssession of facts as to the fraudulent conduct of a claimant until many months or even years after a claim has been allowed. Hence Congress has provided that the only time limitation is the pendency of the bankruptcy proceedings and under Section 57(k) an allowed claim may be reconsidered at any time prior to the closing of the estate.

There is another obvious reason a bankruptcy administrator might not be interested in attempting to subordinate a claim being asserted in the bankruptcy by a person against whom the trustee or receiver is attempting to recover assets for the estate. Surely, judicial notice may be taken that in the greatest number of bankruptcy proceedings no dividends are available for general creditors. Aside from the many cases where there are no assets at all being administered by the bankruptcy court, there are many

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[19]See 3 Collier on Bankruptcy (14th Ed.) 314, Sec. 57(1), and *Boyum v. Johnson* (8th Cir., 1942), 127 F. 2d 491, 49 A. B. R. (N. S.) 228.

cases where the assets that are being administered are completely consumed by prior claims, such as tax and labor claims and expenses of administration. Until the trustee or receiver, as the case may be, has collected all of the assets belonging to the estate and has determined and paid the priority claims, he ordinarily is in no position to know whether or not dividends will be available for the general creditors. For this reason such an administrator might be properly criticized for spending money of the estate in litigating a question of subordination when in fact the question may be academic because nothing will be available for the general creditors in any event. It is neither unusual nor improper for a receiver to first attempt to recover some assets for the bankruptcy estate and, subsequently, when it appears that dividends will be available, to attempt to subordinate a claim to the claims of other creditors if facts come to his attention warranting such relief. This might well have been one of the considerations leading to the inclusion of Section 57(k) in the Bankruptcy Act because it expressly refers to the reallowance or rejection of claims previously allowed "in whole or in part *according to the equities of the case*" at any time before the estate is closed.

The Court of Appeals' refusal to consider the petition for subordination as a petition for reconsideration of the order of allowance of the Bank's claim under Section 57(k) of the Bankruptcy Act is a serious departure from the statutory provisions. There is a definite need for this Court to consider this fundamental question of bankruptcy jurisdiction so as to eliminate any confusion over the lim-

itations placed thereon in the instant case. It is not clear whether the ruling below is that the issue as to subordination was *res judicata,* and, therefore, can never be reconsidered by the bankruptcy court or whether the court merely meant that the bankruptcy court could not reconsider the ruling while the other appeal was pending. It would seem from a reading of the entire opinion that the latter interpretation is correct for otherwise there would have been no need for the Court of Appeals to determine in appellant's favor all of the other issues involved.

For this reason the receiver requested in his petition for rehearing filed with the Court of Appeals that the court direct the bankruptcy court to treat the petition for subordination as a petition for reconsideration, which it should proceed to hear and determine upon return of the mandate from the Court of Appeals. However, that request was denied. The result would seem to be that the rulings of the Court of Appeals that the receiver's petition stated a cause of action and that the bankruptcy court (but for the appeal from the banker's lien order) had jurisdiction to hear and determine it, will be reduced to the status of mere advisory opinions unless this Court exercises its power of supervision in order to make it clear that the receiver is not foreclosed from proceeding upon his petition for subordination after the mandate is returned to the trial court. The receiver has alleged that all of the unpaid creditors of the debtor were misled and injured by the conduct of the Bank; equity and fairness, as well as Section 57(k) of the Bankruptcy Act, require the bankruptcy court to determine those allegations.

## Conclusion.

If this Court does not see fit to grant this petition in its entirety, request is hereby made that the petition be granted for the sole purpose of directing the Court of Appeals to consider the petition to subordinate as a petition seeking reconsideration of the Bank's claim under Section 57(k) of the Bankruptcy Act and that the bankruptcy court be directed by the mandate of this Court, or of the Court of Appeals for the Ninth Circuit, to hear and determine the receiver's petition for subordination. As has been pointed out, the receiver's amended petition to subordinate the Bank's claim was based upon facts obtained through a further investigation and use of the discovery procedure provided by the Federal Rules; we, therefore, respectfully request that the referee be directed to proceed upon the allegations of the receiver's amended petition.

The bankruptcy court is a court of equity having broad, equitable powers that endure so long as the bankruptcy estate remains open. The present estate is open. We respectfully contend for the reasons and upon the authorities hereinabove mentioned that the subordination issues could not have been and were not determined in the banker's lien proceeding and that the contrary ruling of the Court of Appeals for the Ninth Circuit is erroneous, and is in conflict with controlling decisions of this Court and with decisions in the First and Second Circuits. By reason of the importance of the question and the conflict in the Circuits, there is a need for this court to settle once and for

all this important question of jurisdiction of courts of bankruptcy to subordinate claims upon equitable grounds after a claim has been allowed as a valid, legal obligation.

In petitioning this Court for a writ of certiorari we are not unmindful of the small percentage of cases in which certiorari is granted, nor have we failed to consider the fact that in the past several years the percentage is even smaller in bankruptcy cases than in cases involving questions of constitutional law, civil liberties or taxes. Notwithstanding such apparent insurmountable obstacles to the granting of a petition in a bankruptcy matter, we sincerely feel that the record in the instant case presents a question of basic bankruptcy jurisdiction of such far-reaching importance as to warrant consideration by this Court for the guidance of courts of bankruptcy throughout the country. The extension of credit to business firms by small businessmen upon the basis of credit information given by credit reporting agencies or banks is as basic and fundamental to the economy of this country as the first 10 and the 14th Amendments in the Constitution are to the civil liberties of its citizens.

This is not a case where there has been a trial and the trier of fact has resolved conflicting evidence against the petitioner. There was no trial; the case was disposed of upon the pleadings of the petitioner without any answer having been filed by the Bank. Therefore, for the purposes of this petition all of the allegations contained in the pleadings stand admitted. If the ruling below is allowed to stand, the necessary implication is that once a

claim in bankruptcy has been allowed, the bankruptcy court is without jurisdiction to order dividends on the allowed claim to be subordinated to the claims of other creditors upon equitable grounds which had never been theretofore litigated. We do not believe that such conduct is placed beyond the reach of the equitable jurisdiction of courts of bankruptcy merely because the original claim was previously allowed.

Wherefore, it is respectfully urged that this court grant this petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit.

Dated: this 27th day of March, 1951.

GEORGE T. GOGGIN,
*Receiver and Petitioner,*

By MARTIN GENDEL,
*Counsel for Petitioner.*

GENDEL & RASKOFF and
H. MILES RASKOFF,
*Of Counsel.*

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1950.
No. 644

GEORGE T. GOGGIN, Receiver of the Estate of Salsbury Motors, Inc., Debtor,

*Petitioner,*

*vs.*

BANK OF AMERICA NATIONAL TRUST & SAVINGS ASSOCIATION,

*Respondent.*

## BRIEF FOR THE RESPONDENT IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT.

### Opinions Below.

The findings and order of the Referee appear at R. 83-85; those of the District Court at R. 150-152. The opinion of the Court of Appeals [R. 195-202] is reported in 186 F. 2d 158.

### Jurisdiction.

The judgment of the Court of Appeals sought to be reviewed was entered January 5, 1951 [R. 202]. The jurisdiction of this Court is invoked under Title 28 U. S. C. Sec. 1254, as amended by the Act of June 25, 1948 (Pub. L. 773, 80th Cong., 2d Sess., C. 646, 62 Stat. 869) and under Section 24c of the Bankruptcy Act, 11 U. S. C. Sec. 47c.

## Statute Involved.

Section 57 (k) of the Bankruptcy Act, 11 U. S. C. Section 93 (k) provides:

> "Claims which have been allowed may be reconsidered for cause and reallowed or rejected in whole or in part according to the equities of the case, before but not after the estate has been closed."

## Questions Presented.

1. Was the Court of Appeals correct in deciding that where a Referee in a proceeding under Chapter XI of the Bankruptcy Act has made an order that Respondent "shall be entitled to dividends upon (its) claim at the same rate paid to unsecured creditors" and an appeal has been taken therefrom, the Referee is without jurisdiction, pending disposition of the appeal, to hear and determine a petition by the Receiver seeking to subordinate the payment of dividends on the Respondent's claim to the claims of other unsecured creditors?

2. Does the fact that the Receiver in a second proceeding advances reasons for the subordination of the Respondent's claim which were not advanced in his original objections to the claim prevent the Referee's order that the Respondent "shall be entitled to dividends upon (its) claim at the same rate paid to unsecured creditors" from being conclusive upon the issue of parity of the Respondent's claim?

3. Was the Court of Appeals correct in denying the Receiver's petition for rehearing where the ground asserted was urged for the first time on rehearing, had no evidence to support it, and had been expressly abandoned before the Referee?

**Procedural Statement.**

On April 2, 1951, the Petitioner-Receiver filed this Petition for Certiorari, thus attempting to bring before the appellate courts for the eighth time questions relating to the Respondent's right to participate as a creditor in the division of the Debtor's estate.

The history of the litigation is enlightening. More than three years ago the Receiver first filed objections to the allowance of the Bank's claim, contending that the Respondent had illegally exercised its lien rights as a Bank. [R. Case No. 311, October Term, 1950, p. 48.] The objections were determined adversely to the Receiver, the Referee concluding as a matter of law that

> claimant is entitled to participate as an unsecured creditor in all dividends paid upon unsecured claims for the balance of its claim as so determined [R. 178]

and ordering that

> claimant shall be entitled to dividends upon the said claim at the same rate paid to unsecured creditors * * * [R. 179.]

This order was affirmed by the District Court upon review [R. Case No. 311, this term, pp. 109-110], and the Receiver appealed. After an affirming decision by the Court of Appeals, the Receiver petitioned for rehearing. The petition was granted, the case reconsidered on its merits and affirmed [R. Case No. 311, this term, pp. 121-133, 183 F. 2d 322]. The Receiver then petitioned for certi-

orari to this Court. The petition was denied (340 U. S. 877). The Receiver petitioned this Court for rehearing, which was also denied. Almost simultaneously with the filing of his petition for rehearing, the Receiver filed a "Petition for Reconsideration" in the Court of Appeals for the Ninth Circuit, which was denied on December 15, 1950.

Concurrently with the prosecution of the foregoing matters the Receiver brought on for hearing the instant proceeding based upon a petition [R. 58-65] seeking to prevent the Respondent from participating in dividends by accomplishing a relative disallowance of the Respondent's claim. This petition was based upon alleged inequitable conduct more particularly specified *infra*. The Referee and the District Court both decided that they had no jurisdiction to entertain the petition, that no cause of action was stated, and that the Receiver had no authority to prosecute the proceeding [R. 83, 150]. Upon appeal by the Receiver the Court of Appeals affirmed the decision of the District Court holding that the question of priority of the Bank's claim had been decided by the previous order and that the Referee was, therefore, correct in determining that he had no jurisdiction [R. 201]. The Receiver then petitioned for rehearing before the Court of Appeals, which petition was denied. The Receiver now petitions for certiorari to review the decision of the Court of Appeals entered January 5, 1951 [R. 195-202].

**Statement.**

Since the Petitioner's summary of the allegations in these pleadings is inaccurate, we submit our own summary. The Receiver alleged [R. 58-65]:

> The Bank regularly received financial statements from the Debtor. These statements showed that the Debtor was insolvent. The indebtednesses of the Debtor to the Bank were in default. Despite the default the Bank permitted the Debtor to continue to operate and to incur new and additional liabilities. The conduct of the Bank in permitting the Debtor to continue to operate caused other creditors to extend credit to the Debtor. The Bank's failure to declare default of the indebtednesses owing to it "lulled the aforesaid creditors into a feeling of security."
>
> The Bank knew that Northrop Aircraft, Inc. did not intend to be responsible for the obligations of the Debtor; therefore, it would be inequitable to allow the Bank to share in any dividend payable to creditors out of the money paid to the estate by Northrop in compromise of the Receiver's contention that Northrop was obligated to pay the debts of the Debtor.
>
> The Bank in response to many individual credit inquiries by creditors, prospective creditors, and credit agencies, informed such persons that the financial condition of the Debtor was satisfactory. The Bank intimated that Northrop Aircraft, Inc. would supply all necessary financing and capital. The current unpaid creditors extended credit to the Debtor substantially in reliance upon the position taken by the Bank and the misinformation circulated by it in connection with the financial condition of the Debtor.

The Petitioner's summary (Pet. 6) of the allegations contained in the petition and supplement thereto [R. 58-65] erroneously states that these pleadings contained allegations that the Bank "was thoroughly familiar with the many financial reports regularly submitted to it by the Debtor"; that "the Bank was aware of the fact that the Debtor was giving the Bank as a credit reference to all persons making credit inquiries of the Debtor"; that the Bank "gave information to all who inquired that the Debtor was in sound financial condition"; that the Bank "indicated that Northrop would pay the debts of Salsbury, the Debtor"; that the Bank knew the credit information supplied by it "would be included in financial reports distributed by those (credit) agencies."

None of these allegations can be found in the pleadings themselves [R. 58-65].

**Summary of Argument.**

1. The decision of the Court of Appeals is not in conflict with the applicable decisions of this Court or with the decisions of the Courts of Appeals of any other circuits.

2. The decision of the Court of Appeals does not violate Section 57 (k) of the Bankruptcy Act nor is it a decision of far-reaching importance in the orderly administration of the Bankruptcy Act.

## ARGUMENT.

### I.

### Petitioner Has Failed to Demonstrate Any Conflict Between the Decision of the Court of Appeals and the Applicable Decisions of This Court.

The Court of Appeals in fact expressly decided only the single narrow question of whether the appeal from the prior order deprived the Referee of jurisdiction to determine the question of whether or not the Bank's claim should be subordinated to the claims of other creditors [R. 201].[1]

Apparently concluding that the case is one to be determined by the application of principles of *res judicata*,[2] the Petitioner falls into the error of confusing the doctrine

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[1]Contrary to the Petitioner's assertion (Pet. p. 9), the Court of Appeals did not hold that the Receiver's petition stated a claim upon which relief could be granted. The affirming opinion of the Court of Appeals made no comment upon this point because a decision on this question was not necessary to dispose of the case.

The authorities adequately demonstrate that the petition and supplement do not state valid grounds for subordination. *Comstock v. Institutional Investors*, 335 U. S. 211, 230, 92 L. Ed. 1911, 1923 (1948); *Manufacturers Trust Co. v. Becker*, 338 U. S. 304, 94 L. Ed. 107, 70 S. Ct. 127 (1949); *Crowder v. Allen-West Commission Co.*, 213 Fed. 177, 184 (C. C. A. 8, 1914); *Ingram v. Lehr*, 41 F. 2d 169, 170 (C. C. A. 9, 1930); *In re Bowman Hardware & Electric Co.*, 67 F. 2d 792, 794 (C. C. A. 7, 1933).

Neither did the Court of Appeals comment upon the question of whether the Receiver had power or authority to seek the relief requested in his petition to subordinate the Respondent's claim. To the effect that he did not have such power or authority, see *Wallace v. Ohio Valley Bank*, 2 F. 2d 53, 56 (C. C. A. 4, 1924); *In re Railroad Supply Co.*, 78 F. 2d 530, 532 (C. C. A. 7, 1935); *Equitable Holding Corporation v. Woody*, 63 F. 2d 751 (C. C. A. 2, 1933).

[2]The considerations leading to a conclusion that the Referee did not have jurisdiction also lead to the conclusion that the prior order was *res judicata*, although the Court of Appeals expressed only the conclusion regarding lack of jurisdiction.

of estoppel by judgment or collateral estoppel with the doctrine of true *res judicata*. The former doctrine states that a party may be estopped to relitigate an issue actually raised and decided in a prior proceeding, even though the prior proceeding may have been between different parties or on a different cause of action. The doctrine of true *res judicata* states that a party is barred from relitigating an issue decided in a prior proceeding between the same parties founded upon the same cause of action even though the specific issue was not actually raised and litigated in the prior proceeding, if it could have been so raised. [3]

The applicable rule of true *res judicata* is set forth in the Restatement (Judgments, Sec. 63, p. 257) as follows:

> Where a judgment on the merits is rendered in favor of the defendant, the plaintiff is precluded from subsequently maintaining an action on the same cause of action although he presents a ground for the relief asked other than those presented in the original action, except where the defendant's fraud or misrepresentation prevented the plaintiff from presenting such other ground in the original action.

Since there has been a judgment on the merits in Respondent's favor and since there has been no showing that Respondent did anything to prevent the Receiver from asserting the ground he now urges, the only question involved is whether this action by which the Receiver seeks to have the Bank's claim subordinated or relatively disallowed is the same "cause of action" which was determined by the prior order. We submit that it is.

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[3]See Restatement, Judgments, pp. 153-161, where the distinction is well set out.

The Petitioner attempts to draw a distinction between the two phases of his attempt to prevent the Respondent from sharing in the estate on a parity with other creditors. There is no real distinction. The ultimate issue in both phases of the case was whether the Bank's claim on file in the proceedings should be allowed for the purpose of permitting it to participate in dividends. The prime object of having any claim allowed is to entitle it to participate in dividends. The essence of the Receiver's "cause of action," if any, is his asserted right to prevent the assets of the estate from being paid as dividends to an undeserving creditor at the expense of more deserving creditors. The parties in both phases of the case were the same, the fundamental issue was the same, and that issue has been finally resolved in favor of the Respondent. The Receiver's contention that the appeal from the prior judgment did not deprive the Referee of jurisdiction because the grounds which he advanced in the second proceeding were not asserted by him in the first proceeding is, therefore, entirely without merit.

The Petitioner argues that the decision of the Court of Appeals for the Ninth Circuit is in conflict with *Pepper v. Litton,* 308 U. S. 295, 84 L. Ed. 281, 60 S. Ct. 238 (1939). In that case the only issue raised in the prior proceeding in the State Court was whether the State Court judgment should be set aside for violation of a State statute. This Court recognized the doctrine of estoppel by judgment but held that it did not apply in that case because the same fundamental issue, to-wit: whether or not the claimant was entitled to participate in dividends

was not in issue in the State Court proceedings. This Court said (308 U. S. 302):

> When that claim was attacked in the bankruptcy court Litton did not show that the proceeding in the state court was anything more than a proceeding under Virginia practice to set aside the judgment in his favor on the ground that it was irregular or void upon its face. *He failed to show that the judgment in the state court was conclusive in his favor on the validity or priority of the underlying claim, as respects the other creditors of the bankrupt corporation —a duty which was incumbent on him.* (Emphasis ours.)

In the instant case the former judgment ordered "that claimant shall be entitled to dividends upon the said claim at the same rate paid to unsecured creditors * * *" Applying the above quoted language of this Court, it becomes abundantly clear that the judgment in the prior proceeding [R. 178-179] was conclusive in the Bank's favor on the validity and priority of the underlying claim as respects the other creditors of the Debtor.

The Petitioner argues (Pet. 17-18) that the question of whether the Bank's right to participate in dividends should be subordinated was not decided by the order entered in the prior proceeding because the Receiver did not plead in that proceeding the alleged circulation of misinformation by the Bank as an objection to the allowance of the Bank's claim. He urges on the basis of *Vicksburg v. Henson* (1913), 231 U. S. 259; *Radford v. Myers* (1914), 231 U. S. 725; and *Reynolds v. Stockton* (1891),

140 U. S. 254, that the order must be construed in the light of the pleadings and that if it is so construed, it will be concluded that the issue of subordination *vel non* was not involved.

We do not dispute the soundness of the fundamental rules expressed in these cases to the effect that the question of what issues have been decided by a particular order can very often only be ascertained by an examination of the pleadings. But if we analyze the pleadings in the instant case, as was done in *Vicksburg v. Henson, supra,* in order to determine what the real issues were, we arrive at the conclusion that the identical issue: the Bank's right to participate in dividends, was involved in both cases. That being true, the rule of *res judicata* as stated in *Heiser v. Woodruff* (1946), 327 U. S. 726, 735, 90 L. Ed. 970, 66 S. Ct. 853,[4] rather than the rule of *Vicksburg v. Henson,* and the other cases cited above, applies. In *Heiser v. Woodruff, supra,* this Court said (327 U. S. 735):

> In general a judgment is *res judicata* not only as to all matters litigated and decided by it, but as to all relevant issues which could have been but were not raised and litigated in the suit. [Citing *Cromwell v. Sac County* (1876), 94 U. S. 351, 24 L. Ed. 195.]

See also Restatement, Judgments, Sec. 63, p. 257.

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[4]That case held that a prior judgment involving a conclusion that no fraud was committed by a creditor precluded the use of the same fraud as a basis for subordinating the creditor's claim in the bankruptcy.

We submit that in his objections to the Bank's claim previously litigated, the Receiver had ample opportunity to assert the grounds upon which he now bases his petition for subordination. His assertion of different grounds tendered no new fundamental issue. Simply stated, it is the issues which are important, not the grounds asserted as a basis for deciding them one way or the other.

The Petitioner assumes (Pet. 20) that the prior judgment was an interlocutory order and argues that as such the appeal therefrom could not deprive the Bankruptcy court of jurisdiction to proceed with the administration of the estate.

In response to this point it is sufficient to note that, even assuming for purposes of argument that the banker's lien order was an interlocutory order, the taking of the appeal, while not effective to divest the trial court of all jurisdiction over the administration of the bankruptcy, could have no other effect but to divest the trial court of jurisdiction to determine the particular issues involved in the appeal. We do not quarrel with the proposition that an appeal from an interlocutory order in bankruptcy does not divest the trial court of jurisdiction of the entire case, but we think it is equally plain that the trial court is divested of jurisdiction to determine the particular controversy or issue presented in the matter on appeal:

II.

**The Decision of the Court of Appeals Is Not In Conflict With Decisions of the First and Second Circuits.**

The Petitioner argues (Pet. 19) that the decision of the Court of Appeals is in conflict with the case of *Bloch v. Mill Factors Corporation,* 119 F. 2d 536 (C. C. A. 2, 1941). That case is clearly distinguishable on the ground that the objections of the Trustee to the claim were withdrawn before there was any adjudication thereon. There was, therefore, no final adjudication of the claimant's right to participate in dividends which would merge in a judgment the Trustee's right to object. In the instant case the Receiver's objections were maintained, litigated on the merits, and a final decision reached as to the invalidity of the objections and the claimant's right to participate. The *Bloch* case held only that where a trustee has withdrawn objections to a claim, he is not estopped by the allowance thereof from attempting to recover a preference from the claimant.

Raising the point for the first time on rehearing, the Petitioner requested the Court of Appeals to consider the petition and supplement as an application for reconsideration of the allowance of the Respondent's claim pursuant to Section 57(k) of the Bankruptcy Act. The Court of Appeals denied the petition for rehearing. The Petitioner now assumes that because his petition for rehearing was denied, the Court of Appeals erred by refusing to grant his request that the petition and supplement be considered as an applicatioin for reconsideration. In this connection he cites and relies upon dicta in *Bailey v. Proctor,* 166 F. 2d 392 (C. C. A. 1, 1948), as being in conflict with the instant decision of the Court of Appeals.

There are several answers to this argument now advanced as a reason for granting certiorari. Before the Referee, Counsel expressly abandoned the theory which he now urges in support of his petition. He said [R. 157-158]:

> What we are seeking to do by our subordination proceedings is to obtain from this Court an order subordinating any claims of the Bank of America as ultimately allowed. It is true the Bankruptcy Act under its express provision gives the Court the right to re-inquire into any orders made on allowances of claims or objections thereto. *We could proceed under that authority, but we are not.* (Emphasis ours.)

We submit that it is now too late for the Appellant to contend on Petition for Certiorari in this Court that the Petition for Subordination is a petition for reconsideration under Section 57(k) of the Bankruptcy Act. It is fundamental that points not previously raised, particularly points which have been expressly abandoned, provide no valid ground for granting the writ. See *Wm. Cramp & Sons S. & E. B. Co. v. Internat. C. M. T. Co.*, 228 U.S. 645, 648-649, 57 L. Ed. 1003 (1913).

There is a further answer to this argument. Section 57(k) of the Bankruptcy Act expressly provides that claims allowed may be reconsidered "for cause." Counsel's argument in the third section of the petition, therefore, constitutes an attempt to get this Court to prejudge the question of whether any "cause" exists for reconsideration, without benefit of evidence or consideration or decision by a trial court.

The last portion of the petition (Pet. 29-30) is devoted to a request to this Court to direct the trial court to treat the petition for subordination as a petition for

reconsideration under Section 57(k) of the Bankruptcy Act. It is believed that the arguments set forth above adequately demonstrate that the Receiver's request in this respect is both out of order and unnecessary. Furthermore, this Court will not assume in advance of decision by a court below that the trial court will not afford the Petitioner every legal right given him by Section 57(k) of the Bankruptcy Act.

The refusal of the Court of Appeals to grant a rehearing upon the Receiver's request that his petition be treated as a petition for reconsideration under Section 57(k) of the Bankruptcy Act cannot in any sense of the word be considered as a limitation upon the applicability of Section 57(k) in a proper case. The narrowness of the scope of the decision by the Court of Appeals prevents it from being, as Petitioner argues, a decision of far-reaching importance in the future administration of bankrupt estates.

## Conclusion.

This matter has been litigated, decided, reheard, and redecided to such an extent that the time has come to end it. We respectfully submit that the Petition for Certiorari should be denied because it is entirely without merit.

Dated this 26th day of April, 1951.

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ROBERT H. FABIAN,
*Attorneys for Respondent.*

SAMUEL B. STEWART, JR.
*Of Counsel.*

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1950

No. 644.

GEORGE T. GOGGIN, as Receiver of the Estate of Salsbury Motors, Inc., Debtor,

*Petitioner,*

*vs.*

BANK OF AMERICA NATIONAL TRUST & SAVINGS ASSOCIATION,

*Respondent.*

**Reply Brief of Petitioner in Support of Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.**

*To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:*

Your petitioner herein is seeking a review by this Court of a judgment of the United States Court of Appeals for the Ninth Circuit which affirmed an order of the bankruptcy court denying a petition of the receiver to subordinate the claim of the Bank of America under a confirmed plan of arrangement. There was no hearing on the merits because the referee and the district judge were of the opinion that the bankruptcy court was without jurisdiction to entertain the petition. The receiver sought in his peti-

tion to defer any payment of dividends to the Bank on its claim against the debtor until all the other creditors of the debtor had been paid, upon the ground that the Bank was guilty of such misconduct in dealing with all the other creditors of the debtor as to require the bankruptcy court, under the doctrine of *Pepper v. Litton* (1939), 308 U. S. 295, 84 L. Ed. 281, 60 S. Ct. 238, 41 A. B. R. (N. S.) 279, to subordinate the payment of dividends on the Bank's claim in order to prevent injustice and unfairness in the administration of the estate. The drastic judgment of the court below would operate to deny the receiver the opportunity to prove the conduct of the Bank, which was described in the receiver's original petition and supplement thereto [Tr. 58-65], and the amended petition [Tr. 92-107], so that the truth and significance of the facts alleged by the receiver can be ascertained.

The reasons underlying a judgment or order which denies a party his day in court should be compelling. It is upon this ground that the courts have universally applied the rule that in cases sought to be determined upon their pleadings, every inference must be drawn in favor of the pleader, and that, in ruling upon the sufficiency of the pleadings, the allegations thereof are deemed admitted. The position of the Bank, as set forth in its brief in opposition to the writ, is grounded upon a rejection of these fundamental and elementary principles.

The sole contention of the Bank is that in bankruptcy proceedings the allowance of a claim over objections necessarily adjudicates any and all issues pertaining to the

order of payment of dividends on that claim.[1] Stated otherwise, the Bank takes the position that once a claim has been allowed by the bankruptcy court, that court is forever precluded, not only from reconsidering that allowed claim, but also from considering whether or not dividends shall be paid on that claim at the same time dividends are paid to other creditors who have been preju-

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[1]This is a rejection of the rule of *Pepper v. Litton* in which this Court stated:

> "Though disallowance of such claims will be ordered where they are fictitious or a sham, these cases do not turn on the existence or non-existence of the debt. Rather, they involve simply the question of order of payment." 308 U. S. 295, at 310, 84 L. Ed. 281, 60 S. Ct. 238, 41 Am. B. R. (N. S.) 279.

In the first footnote to its brief herein on page 7 thereof, the Bank questions whether or not the original petition and the amended petition to subordinate the Bank's claim herein state valid grounds for subordination. The Bank refers to *Comstock v. Institutional Investors,* 335 U. S. 211, 92 L. Ed. 1911, and *Manufacturers Trust Co. v. Becker,* 338 U. S. 304, 94 L. Ed. 107, 70 S. Ct. 127. Each of these cases involved a full hearing upon a petition to subordinate upon the basis of which this Court concluded that subordination should not be granted. In neither case was there any question as to the right of the bankruptcy court to order subordination upon appropriate findings and there was implicit in both rulings a reaffirmation of the basic principle that the bankruptcy court has jurisdiction to hear and determine such petitions to subordinate.

After citing the two Supreme Court cases, the Bank refers to several United States Court of Appeals cases, the most recent of which was decided in 1935 and all of which preceded *Pepper v. Litton.* Among the numerous cases recognizing the power of the bankruptcy court to subordinate the payment of dividends on allowed claims are the following:

*In re Headley* (1899, D. C., Mo.), 97 Fed. 765, 3 A. B. R. 272;

*In re Royce Dry Goods* (1904, D. C., Mo.), 133 Fed. 100, 13 A. B. R. 257;

*Carter v. Bogden* (1926, 8th Cir.), 13 F. 2d 90, 8 A. B. R. (N. S.) 247;

(Footnote continued on following page.)

diced by the misconduct of the claimant. Upon this premise the Bank argues that the question presented by the instant case is of no importance and should, therefore, not be considered by this Court.

That such propositions are being urged demonstrates the compelling need for this Court to grant the petition herein.

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*Bird & Sons v. Tobin* (1935, 8th Cir.), 78 F. 2d 371, 100 A. L. R. 654, 29 A. B. R. (N. S.) 171;

*Pepper v. Litton* (1939), 308 U. S. 295, 84 L. Ed. 281, 60 S. Ct. 238, 41 A. B. R. (N. S.) 279;

*Bank of America v. Erickson* (1941, 9th Cir.), 117 F. 2d 796, 45 A. B. R. (N. S.) 503;

*Goldie v. Cox* (1942, 8th Cir.), 130 F. 2d 695, 50 A. B. R. (N. S.) 560;

*Prudence Realization Corp. v. Geist* (1942), 316 U. S. 89, 86 L. Ed. 1293, 62 S. Ct. 978;

*Columbia Gas & Electric Corp. v. U. S.* (1945, 6th Cir.), 151 F. 2d 461, rehear. den. 153 F. 2d 101, *cert den.* 329 U. S. 737;

*In re Loewer's Gambrinus Brewery Co.* (1948, 2nd Cir.), 167 F. 2d 318;

*In re Inland Gas Corp.* (decided March 19, 1951, 6th Cir.), reported at paragraph 56,956 of Commerce Clearing House Bankruptcy Service in the issue of April 18, 1951.

In the light of these authorities there can be no reasonable difference of opinion over the proposition that the Bankruptcy Court has complete jurisdiction to order subordination of a claim to other claims of the same class whenever the facts require such an order to further the ends of equity and justice in the distribution of the assets of a bankruptcy estate. These authorities also establish that a trustee in bankruptcy, or a receiver, has not only the power but the duty to bring appropriate proceedings toward this end. The pleadings in the instant case (both the original and amended petitions) fall within the rules of these cases and if, after a trial, the receiver proves those allegations, the bankruptcy court would be required to order that payment of dividends on the Bank's claim be subordinated to the claims of all other creditors.

See also in this connection:

3 Collier on Bankruptcy (14th Ed.) 185, 1809-1810;

6 Remington on Bankrupcty 477;

6 Remington on Bankruptcy (1947 Supp.), 138.

## ARGUMENT.

### I.

### The Banker's Lien Proceeding Did Not Involve Any Issue or the Consideration of Any Evidence as to the Subordination of the Bank's Claim and, Therefore, Could Not Have Determined Any Such Issue; Ergo, There Could Be No Basis for Res Judicata.

In attempting to establish that there was no real distinction between the banker's lien proceedings and the subordination proceedings the Bank makes the following bald assertion to page 9 of its brief herein:

> "The ultimate issue in both phases of the case was whether the Bank's claim on file in the proceedings should be allowed for the purpose of permitting it to participate in dividends."[2]

An examination of the record in the banker's lien proceeding unequivocally demonstrates that there was never an issue as to the Bank's ultimate right to participate in dividends. As a matter of fact, there was never any question but that the debtor was indebted to the Bank. The pleadings [B. L., Tr. 48, 37] and the evidence [B. L., Tr. 68] in the banker's lien proceedings show that the only issue was the amount of the Bank's claim, the receiver contending that the Bank's claim should have been in a greater amount than that claimed by the Bank because the Bank had wrongfully asserted a lien on certain

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[2]Even if this were true (which it is not) the bankruptcy court would have the authority to reconsider the allowance of a claim at any time while the bankruptcy proceedings are pending. See Sections 57(k) and 57(l) of the Bankruptcy Act and the discussion contained at pages 25 to 29 of the petition for certiorari herein.

moneys and properties belonging to the debtor. At no time did the receiver attempt to defeat the claim of the Bank. In the banker's lien proceedings the receiver sought to defer a determination of the amount of the Bank's claim until the value of the security asserted by the Bank had been determined.

The second and basic aspect of the banker's lien proceeding was a counterclaim in which the receiver sought to have the Bank turn over to the estate the commercial paper, or the proceeds therefrom, upon which the Bank had asserted a banker's lien. It is thus clear that the receiver never contended that the Bank did not have a valid claim against the debtor.

The Bank concedes on page 11 of its brief herein that in determining the scope and effect of any judgment or order the Court must resort to the pleadings and evidence presented in the earlier proceedings to determine whether or not the issues raised by the more recent litigation were determined in the previous litigation.[3] Never-

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[3]See *Vicksburg v. Henson* (1913), 231 U. S. 259; *Radford v. Myers* (1914), 231 U. S. 725, and *Reynolds v. Stockton* (1891), 140 U. S. 254.

In *Vicksburg v. Henson,* this Court stated, at 231 U. S. 268:

> "Coming to the question whether the former decree disposed of the rights of the parties, as was held in the court below, which judgment was affirmed by the Circuit Court of Appeals, it is undoubtedly true that a right, question or fact put in issue and decided by a court of competent jurisdiction must be taken as settling the rights of the parties in respect to such controversy and while it remains undisturbed is conclusive between them. The enforcement of this rule has been repeatedly said to be essential to secure the peace and repose of society and in order that an end may be made of controversies between parties who have once invoked and have had the determination by a competent judicial tribunal of the matters in dispute between them. It is no less true that to hold

(Footnote continued on following page.)

theless, it is unable to demonstrate from the record in the banker's lien proceedings, either in the pleadings or the evidence, where there was an issue as to the Bank's right to participate in dividends. The only thing in the entire record in the banker's lien proceedings in any way remotely pertaining to the participation in dividends is the last paragraph of the order of the referee. This contained the only language relied upon by the Court of Appeals and the Bank. That language, read in context, was merely a direction to the receiver that no dividends were to be paid to the Bank until its security had been liquidated. Obviously, until that time, the exact amount of the Bank's claim would be unknown. A recent decision of the Court of Appeals for the Second Circuit makes it

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upon any unsubstantial ground that a controversy has been thus concluded is to do an injustice to litigants. We must therefore be careful to see, when the contention of former adjudication is made, that the matter was actually presented and decided and the rights of the contending parties thereby concluded. We think that an examination of the record in the former case, put in evidence in this case, does not support the contention that the matter here in issue was then adjudicated and determined."

There this Court reversed a judgment of the Court of Appeals for the Fifth Circuit which had, as did the Court of Appeals in the instant case, upheld a plea of *res judicata* by reason of a strained literal construction of the judgment in an earlier case.

The same principle was applied by this Court in *Pepper v. Litton.* Although a claim asserted in a bankruptcy was based upon a final binding judgment of a state court, this Court, nevertheless, held that the judgment was not *res judicata* in a bankruptcy proceeding when the trustee attempted to subordinate the payment of dividends on the claim based upon the judgment because the record of the state court proceeding showed that the issues as to subordination had never been raised. The only distinction between that case and our case is that the *Litton* judgment was issued by a state court whereas in our case the order in the banker's lien proceedings was issued by the bankruptcy court. The position of the Bank would give the judgment of the bankruptcy court a greater finality than that of a state court, even though the evidence and pleadings raised no issue concerning subordination.

clear that under the Bankruptcy Act there may never be a final allowance of a secured claim until the security has been liquidated or appraised. In *New York, N. H. and H. R. Co. v. Reconstruction Finance Corporation* (2nd Cir., 1950), 180 F. 2d 241, the question presented was whether the bankruptcy court had jurisdiction to entertain a petition requesting the same relief that had been previously denied by the bankruptcy court. In that case the denial was affirmed by the Court of Appeals on an appeal from the original order which had long since become final prior to the filing of the new petition. As already pointed out, the second petition was for the same relief that had already been denied. However, there was a different legal ground urged to support the second petition. Judge Learned Hand, speaking for the Court, stated that the bankruptcy court had jurisdiction to entertain the new petition and that if the bankruptcy court had any discretion whether to entertain the petition or not, it would have been an abuse of discretion not to do so[4] (180 F. 2d at 243).

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[4]Judge Hand made the following pertinent observation as to the finality in bankruptcy proceedings of any order allowing a secured claims:

> "On the other hand, §57, sub. e, provides that secured claims shall be only 'temporarily' allowed; and then only for purposes of voting, and at amounts which 'seem' to the court to represent the deficiency of the security to pay them in full. Section 57, sub. h, provides for the liquidation of the security, which is to be, either in accordance with the terms of the agreement between the bankrupt and the creditor, or by compromise, or litigation, 'as the court may direct.' The important thing is that there is to be no 'allowance'—except the 'temporary' one—until the value of the security has been ascertained, and that, when it has been ascertained, is to be 'credited' upon the claim and dividends are to be paid only upon the balance. Thus there could be no final 'allowance' of the claim in suit until the amount of the security had been appraised, which involved as one factor the interest in dispute." (180 F. 2d 246.)

The case of *New York, N. H. and H. R. Co. v. Reconstruction Finance Corporation, supra,* is in direct conflict with the ruling of the Court of Appeals for the Ninth Circuit in the instant case.

## II.

## The Allowance of a Claim in Bankruptcy May Be Reconsidered at Any Time While the Bankruptcy Proceedings Are Open.

For the reasons stated in the petition herein and in the foregoing portions of this reply brief, the banker's lien order was not *res judicata* as to any issue presented by the petition for subordination. However, if it be assumed for the purposes of this argument, as held by the Court of Appeals, that ". . . the last paragraph of said [banker's lien] order decided the question of priority of the bank's claim . . ." [Tr. 201], the ruling that it necessarily follows that the bankruptcy court was without jurisdiction to reconsider that order is in direct conflict with the Bankruptcy Act and the governing authorities thereunder. No purpose would be served by repeating the discussion of the authorities contained in the petition for certiorari; we only mention them herein to point out that nowhere in the Bank's brief has any answer been made to them. Just as the Court of Appeals and the Bank have taken out of context language from the banker's lien order the Bank has, on page 14 of its brief herein, quoted out of context a statement of counsel before the referee in a strained effort to support a conclusion that the receiver waived the right to ask the bankruptcy court to reconsider the allowance of the Bank's claim. The record before this Court does not

contain the complete transcript of the hearing in which the statement of counsel quoted by the Bank on page 14 of its brief appeared. However, even the portion included in the record shows that the quoted language does not have the meaning given it by the Bank when considered in its context. The statement of counsel appears in this record at page 157 thereof and reads as follows:

> "At this time we are not objecting to the allowance of any claims of the Bank of America. If that is not clear from our pleadings, it is only because they have not read those pleadings. What we are seeking to do by our subordination proceedings is to obtain from this Court an order subordinating any claims of the Bank of America as ultimately allowed. It is true the Bankruptcy Act under its express provision gives the Court the right to reinquire into any orders made on allowance of claims or objections thereto. We could proceed under that authority, but we are not. We are proceeding on the basis that whether the claims of the Bank of America amount to $198,818.44, as it will amount to in the gross if the banker's lien litigation is affirmed, or if reversed it will be in some greater amount, but whatever amount is allowed ultimately that the payment of dividends on that allowed claim are subordinated."

It clearly appears from the foregoing that all counsel was stating was that until the banker's lien litigation became final the Bank's claim could not be liquidated, but that in any event, whether the receiver was successful or not, the Bank would have an allowed claim; further, that the receiver was attempting, upon the basis of his petition to subordinate, to present evidence to the Court

that the Bank's claim, in whatever amount it was ultimately found to be, be deferred until the claims of other creditors, misled by the conduct of the Bank, were paid in full. Clearly there was no waiver of any rights under Section 57(k) of the Bankruptcy Act. The receiver's counsel was merely contending that the subordination proceedings were separate and distinct from the banker's lien proceedings and, therefore, a motion to reconsider the banker's lien order was inappropriate at that time. If the ruling of the Court below, however, is correct, counsel for the receiver made the statement under an apparently erroneous legal theory. But this does not prevent reconsideration; in fact, a refusal to reconsider an order in these circumstances would be an abuse of discretion according to the Court of Appeals for the Second Circuit in *New York, N. H. and H. R. Co. v. Reconstruction Finance Corporation* (1950), 180 F. 2d 241, where the Court stated:

> "Rule 60(b)(1), Federal Rules of Civil Procedure, 28 U. S. C. A., would have given him discretion to relieve the trustees from their 'excusable neglect' in failing to adduce all the appropriate legal grounds to support their claim; and it is obvious that he would have exercised his discretion in their favor; indeed, it would have been an abuse of it not to do so."

Since the filing of the petition herein another circuit has come down with a ruling in conflict with the Court of Appeals for the Ninth Circuit in the instant case. In the case of *In re Inland Gas Corp.*, decided March 19,

1951, the United States Court of Appeals for the Sixth Circuit squarely held that the bankruptcy court was not to be precluded from reconsidering the same questions as were presented on a former appeal in which the mandate had long since become final. The Court stated:

> ". . . Here the securities of Columbia were tainted with inequity from the very beginning, and no reasonable expectation may be indulged that in the present status of the debtors there may come a time when Columbia may assert any right in such securities as against creditors who have not been injured by its illegal and inequitable conduct. This is not to say that subordination is not a more appropriate remedy than rejection, in view of the principle applied in the *Hartford-Empire* case, if by it a just result may be reached. Nor are we precluded by our previous mandate, even if susceptible to the interpretation put upon it by the district court, from considering whether the plan of reorganization, now for the first time presented, is, in the light of all circumstances brought forth, fair and equitable, since the allowance of claims in bankruptcy remains interlocutory until the estate has been closed, *New York, N. H. & H. R. Co. v. Reconstruction Finance Corp.,* 180 Fed. (2d) 241, 243 (C. A. 2), and no application of the principle of 'the law of the case' need deter us from so doing, in an exceptional case, which this is, *Reynolds Spring Co. v. L. A. Young Industries,* 101 Fed. (2d) 257 (C. A. 6), however such principle may circumscribe the action of a district court."[5]

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[5]The official citation for this case is not yet available but it may be found at paragraph 56,956 of the C. C. H. Bankruptcy Service in the issue of that service dated April 18, 1951.

## Conclusion.

The Bank apparently asserts that the scope of the decision of the Court of Appeals in the instant case is so narrow as to make it unworthy of consideration by this Court. The holding of the Court below seems to have been predicated upon an extremely narrow issue but it is one that, if allowed to stand, will mean that a bankruptcy court may never entertain a petition to subordinate the payment of dividends upon a claim if that claim has been previously allowed. This is in direct conflict with decisions of this Court, with decisions in the First, Second and Sixth Circuits, with the express provisions of Section 57 of the Bankruptcy Act, and is of vital importance to the uniform administration of the Bankruptcy Act throughout the United States.

We cannot resist the temptation to point out that, by refusing to grant the Petition for Certiorari in the Bankers lien litigation, this Court, in effect, permitted the Bank to prefer itself over other creditors to the extent of approximately $180,000, in addition to the fact that the Bank exercised its right of setoff and seized over $160,000 in cash then on deposit when the Chapter XI proceedings commenced. If the within Petition for Writ of Certiorari is denied, the net result will be that the reprehensible conduct of the Bank, complained of in the subordination pleadings before the Referee (and admitted here) seeking relief by way of subordination of payment of dividends on the claim of the Bank, will never receive the consideration of a court of equity. While we would be reluctant to urge that the position of the Bank is frivolous, we cannot believe that it is completely serious in arguing that an objection to a claim on the basis that the claimant has wrongfully converted moneys belonging

to the estate is the same as a petition seeking to subordinate the payment of dividends on an allowed claim because of the inequitable conduct of the claimant, prior to bankruptcy, in dealing with all of the creditors.

After carefully combing the record, pleadings and briefs submitted to the Court of Appeals, we are still unable to ascertain what motivated the Court below to recognize what appears to be such an untenable argument, particularly in view of the fact that even if the Court of Appeals erroneously thought the Referee below intended to pass on the question of dividends in the Bankers' lien litigation, nevertheless it completely failed to consider the decisions of this Court, at least two other circuits (now enlarged by the Sixth Circuit ruling in the case of *In re Inland Gas Corp.,* decided March 19, 1951), and the express provisions of the Bankruptcy Act providing for reconsideration of claims and the payments of dividends thereon at any time prior to the closing of a bankruptcy administration. Certainly, if the Bankrupty Act spells out the right of a Receiver or Trustee to seek the return of a dividend which was subsequently determined to hav been erroneously paid (Section 57(1)), how could the Court of Appeals justify its conclusion that the Court below had no jurisdiction to either reconsider its ruling or to consider new matters seeking different relief?

As pointed out by the Bank in the conclusion of its brief herein, the receiver has been engaged in extensive litigation with the Bank arising out of the within Chapter XI proceedings. The receiver has been before the Circuit Court and this Court previously in order to question the propriety of the Bank's exercise of a banker's lien by reason of which it obtained in excess of $180,000 before any other creditors of the debtor received anything. The

receiver is now before this Court a second time after being unsuccessful before the Referee, the District Court, and the Court of Appeals, only because he feels so strongly that established principles of bankruptcy law, as well as equity and justice, require the granting of an opportunity to prove that the conduct of the Bank prevents it from participating in the distribution of the assets of the estate until the creditors who were misled by the Bank's wrongful conduct have been paid.

Wherefore, it is respectfully urged that the petition for writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit be granted, that the judgment of that Court be reversed, that the entire matter be remanded to the bankruptcy court with directions to proceed upon the allegations of the receiver's amended petition to subordinate the claim of the Bank of America.

Dated: This 9th day of May, 1951.

Respectfully submitted,

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H. MILES RASKOFF,
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